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No. 06-480

IN THE
Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.

Petitioner,

v.

PSKS, INC., D/B/A/ KAY'S CLOSET . . . KAY'S SHOES,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF THE AMERICAN PETROLEUM INSTITUTE AS AMICUS CURIAE SUPPORTING PETITIONER

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INTEREST OF AMICUS CURIAE

The American Petroleum Institute ("API"), a non-profit District of Columbia corporation, is a national trade association for the U.S. oil and natural gas industry.[1] API's more than 400 members cover all facets of the industry, including exploration, production, transportation, refining, and marketing. Many of API's member companies are engaged in marketing petroleum products through dealers. API's members thus have a strong interest in the antitrust question before the Court in this case.

API frequently participates in legislative, administrative, and judicial proceedings that present issues of national concern, including issues involving interpretation of the antitrust laws. API participated as an *amicus curiae* in *State Oil v. Khan*, 522 U.S. 3 (1997), and has also participated in other cases before this Court presenting antitrust issues. *See, e.g., Bell Atlantic Corporation v. Twombly*, No. 05-1126 (argued Nov. 27, 2006); *Texaco, Inc. v. Dagher*, 126 S. Ct. 1276 (2006); *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 126 S. Ct. 860 (2006).

STATEMENT

Petitioner Leegin Creative Leather Products, Inc. produces women's fashion accessories. Since 1990,

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[1] Letters from Petitioner and Respondent consenting to the filing of amicus briefs are on file with the Clerk. Pursuant to Supreme Court Rule 37.6, counsel for API states that no counsel for a party authored this brief in whole or in part, and that no person or entity other than API, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

Petitioner has produced the "Brighton" brand line of women's belts and other accessories. Petitioner's marketing strategy for its Brighton line focuses on boutique stores offering a high level of service and personal attention. Pet. 2; 6 R. 5-11. In 1997, Petitioner adopted the "Brighton Pricing and Promotion Policy," which stated that Petitioner would do business only with retailers that followed Petitioner's suggested retail prices. Pet. 3; 6 R. 10. (The policy did not apply to Brighton products that a retailer chose not to reorder from Petitioner. Pet. 3 n.2.). Petitioner adopted the policy because it concluded that periodic sales would degrade the Brighton brand and cause customers to feel disaffected when they bought products that were not on sale. Pet. 3; 5 R. 106-24. Petitioner instead adopted an "everyday fair price" strategy. *Id.* In addition, Petitioner believed its policy would develop the Brighton brand by giving retailers an incentive to focus on Brighton products and provide a high level of service to customers. Pet. 3; 5 R. 115-27. Sales of Brighton products increased after the pricing policy went into effect. For example, sales of Brighton handbags grew from 125,609 units in 1996 to 375,480 units in 2003. Pet. 3.

Respondent PSKS sold Brighton products at its retail store, known as "Kay's Kloset," in Lewisville, Texas. Pet. 4. In late 2002, Petitioner learned that Respondent was selling Brighton products below the suggested retail prices. Pet. 4; 6 R. 112-13. In accordance with its policy, Petitioner suspended all shipments of Brighton products to Respondent. *Id.*

Respondent filed an action in federal district court contending that Petitioner's pricing policy amounted to an unlawful agreement in restraint of trade, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. The district court barred Petitioner from introducing evidence that it lacks market power. In addition, the court excluded evidence that Petitioner's pricing policy promotes rather

than harms interbrand competition. The district court also denied Petitioner's request for a jury instruction that would have allowed the jury to apply the rule of reason. Instead, the court instructed the jury that the alleged resale price maintenance agreement was *per se* illegal. Pet. 4; 11 R. 42.

The jury found that Petitioner's policy constitutes a resale price maintenance agreement, and awarded Respondent $1.2 million in damages, which was trebled. The total judgment against Petitioner, including attorney's fees, was $3.975 million. Pet. App. 3a. In denying Petitioner's motion for judgment as a matter of law or for a new trial, the district court observed that "[w]hether the per se classification of such agreement is wise is not for this court to decide." *Id.* at 12a.

The court of appeals affirmed, noting that the lower courts "remain bound by [this Court's] holding in *Dr. Miles* [*Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)]." Pet. App. 4a.

SUMMARY OF ARGUMENT

Section 1 of the Sherman Act, 15 U.S.C. § 1, prohibits only unreasonable restraints of trade. Ordinarily, a court determines whether a particular restraint of trade is unreasonable by applying the rule of reason, which requires the court to weigh the procompetitive benefits of a challenged practice against its anticompetitive harm. The Court has dispensed with case-by-case evaluation, and applied a *per se* rule of illegality, only when experience with a particular kind of restraint enables the Court to predict with confidence that the practice always, or almost always, harms competition.

In *State Oil v. Khan*, 522 U.S. 3 (1997), the Court overruled its decision in *Albrecht v. Herald Co.*, 390 U.S.

145 (1968), and held that vertical maximum resale price maintenance should be analyzed under the rule of reason rather than the *per se* rule. The Court relied on its decisions since *Albrecht*, which had substantially weakened its analytical underpinnings, as well as scholarly criticism of the decision.

The principles this Court recognized in *State Oil* support the conclusion that vertical minimum resale price maintenance, like vertical maximum resale price maintenance, should be analyzed under the rule of reason. There is widespread agreement among legal and economic scholars that vertical minimum resale price maintenance is not always, or almost always, anticompetitive. Minimum prices may enhance competition by ensuring that dealers provide the optimum level of service to consumers and preventing free-riding by dealers offering a lower level of service. Minimum prices may also encourage dealers to carry a larger quantity or selection of the manufacturer's products, or to provide shelf space for a new product.

There is no persuasive reason to draw a sharp line between vertical minimum resale price maintenance and other vertical restraints. As the Court has recognized, all vertical restraints have the potential to allow dealers to increase prices, and can be characterized as intended to do just that. Manufacturers have no incentive to provide services that consumers do not want, because doing so will likely decrease the manufacturers' overall sales and profits. Although vertical minimum resale price maintenance may harm competition in some circumstances, such as when it is used to facilitate horizontal price fixing among dealers or manufacturers, application of the rule of reason, together with the *per se* rule against horizontal price fixing, will protect consumers and competition without deterring procompetitive conduct. Accordingly, the Court should

reconsider its decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and apply the rule of reason rather than the *per se* rule to vertical minimum resale price maintenance.

The Court's decision in *Dr. Miles* should be reconsidered for the additional reason that its application often turns on unpredictable and economically irrelevant factors. This Court's decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), which held that a manufacturer may unilaterally refuse to do business with dealers that decline to adhere to the manufacturer's suggested resale prices, has led to litigation over whether a manufacturer and a dealer can be said to have entered into an agreement on resale prices. This litigation focuses on issues of little or no economic significance, such as the quantity and quality of the communications between manufacturer and dealer, and has led to inconsistent and unpredictable results. *Dr. Miles* thus violates the principle that departures from the rule of reason must be based on demonstrable economic effects rather than formalistic line drawing.

Reconsideration of the proper antitrust analysis of vertical minimum resale price restraints is consistent with principles of *stare decisis*. In *Dr. Miles*, which was decided before this Court adopted the distinction between the rule of reason and the *per se* rule, there was evidence that the resale price restriction resulted from a horizontal price-fixing agreement among wholesale druggists. Moreover, the doctrine of stare decisis is not an inexorable command. The Court has overruled its statutory precedents where, as in this case, subsequent legal developments have removed the conceptual underpinnings of the prior decision. The usual rule that legislative changes should be left to Congress has less weight in cases interpreting the Sherman Act, because it has long been understood that Congress expected the

courts to draw on the common-law tradition to give meaning to the broad language of Section 1 of the Sherman Act. The Court has overruled its prior precedents with respect to vertical nonprice restraints and vertical minimum resale price maintenance; it should follow the same course with respect to vertical maximum resale price maintenance.

ARGUMENT

I. The *Per Se* Rule Is Reserved For Activities That Experience Has Shown Are Always, Or Almost Always, Anticompetitive.

"[T]his Court has long recognized that" Section 1 of the Sherman Act was "intended to outlaw only *unreasonable* restraints" of trade. *Texaco, Inc. v. Dagher*, 126 S. Ct. 1276, 1277 (2006), quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). *See also Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). In determining whether a particular restraint is unreasonable, the Court's inquiry "is confined to a consideration of impact on competitive conditions." *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 690 (1978).

"Ordinarily, whether particular concerted action violates § 1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason – that is, 'the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'" *Business Electronics*, 485 U.S. at 723, quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). The Court "presumptively applies rule of reason analysis." *Dagher*, 126 S. Ct. at 1279; *Business Electronics*, 485 U.S. at 726 (same).

In limited circumstances, the Court has departed from the rule of reason standard by holding that certain

categories of agreements are illegal *per se*, thus "dispensing with the need for case-by-case evaluation." *Business Electronics*, 485 U.S. at 723. The Court has reserved the *per se* rule for "'conduct that is manifestly anticompetitive,'" *i.e.*, conduct "'that would always or almost always tend to restrict competition and decrease output.'" *Id.*, quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985), quoting, in turn, *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979). The Court has explained that "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable." *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982). In contrast, "'where the economic impact of certain practices is not immediately obvious,'" the Court has "'expressed reluctance to adopt *per se* rules.'" *Dagher*, 126 S. Ct. at 1279, quoting *State Oil*, 522 U.S. at 10, quoting, in turn, *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458-59 (1986).

II. In *State Oil*, the Court Reexamined Vertical Maximum Resale Price Maintenance And Held That It Is Subject To The Rule of Reason Rather Than the *Per Se* Rule.

In *State Oil*, the Court reexamined its decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), which held that vertical maximum resale price maintenance is subject to the *per se* rule. As a result of this reexamination, the Court unanimously held that vertical maximum resale price maintenance is properly analyzed under the rule of reason rather than the *per se* rule.

The Court's opinion in *State Oil* reviewed its decisions "leading up to and beyond" *Albrecht*. 522 U.S. at 10. The Court began with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which held that it was unlawful for manufacturers or suppliers to set

minimum resale prices to be charged by their distributors. The Court's opinion in *Dr. Miles* reasoned that suppliers should not be permitted to place "restraints upon alienation" of goods once title has passed to the dealer. 220 U.S. at 404. In *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967), the Court extended this reasoning to vertical non-price restraints, holding that, "upon the transfer of title to goods to a distributor," a supplier's assignment of exclusive dealer territories is a *per se* violation of Section 1.

In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court reconsidered its decision in *Schwinn*. The Court observed that "[t]he great weight of scholarly opinion has been critical of [*Schwinn*], and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach." *Id.* at 47-49. The Court determined that "departure from the rule-of-reason standard must be based upon demonstrable economic effects rather than–as in *Schwinn*–upon formalistic line drawing." *Id.* at 58-59.[2]

Subsequent decisions of the Court "hinted that the analytical underpinnings of *Albrecht* were substantially weakened by *GTE Sylvania*." *State Oil*, 522 U.S. at 14. The Court recognized "that horizontal restraints are generally less defensible than vertical restraints," *Maricopa County*, 457 U.S. at 348 n.18. In addition, the Court observed that "a vertical restraint imposed by a *single* manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand

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[2] "The Court acknowledged the principle of *stare decisis*, but explained that the need for clarification in the law justified reconsideration of *Schwinn*." *State Oil*, 522 U.S. at 13, citing *GTE Sylvania*, 433 U.S. at 47-49. *See infra*, pp. 19-21 (discussing doctrine of *stare decisis*.)

competition." *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-42 (1987).

The Court's analysis in *State Oil* was informed not only by its prior decisions, but also by the "considerable body of scholarship discussing the effects of vertical restraints," as well as the Court's "general view that the primary purpose of the antitrust laws is to protect interbrand competition." *State Oil*, 522 U.S. at 15, citing *Business Electronics*, 485 U.S. at 726. "So informed," the Court could not conclude "that vertically imposed maximum resale prices could harm consumers or competition to the extent necessary to justify their *per se* invalidation." 522 U.S. at 15.

In reaching this conclusion, the Court rejected "a number of theoretical justifications" for the *per se* rule of *Albrecht*. The *per se* rule had been defended on the ground that it promoted "dealer freedom," but the Court noted that it "actually prompted many suppliers to integrate forward into distribution, thus eliminating the very independent trader for whom *Albrecht* expressed solicitude." *Id.* at 16, quoting 9 P. Areeda, *Antitrust Law* ¶ 1635, p. 395 (1989). The Court also rejected the argument that the *per se* rule avoids situations in which "maximum prices may be set too low for dealers to offer consumers essential or desired services." 522 U.S. at 17. The Court observed that "such conduct, by driving away customers, would seem likely to harm manufacturers as well as dealers and consumers, making it unlikely that a supplier would set such prices as a matter of business judgment." *Id.* at 17 (citations omitted). The Court also rejected the argument that vertical maximum prices "channel distribution through large or specially advantaged dealers," noting that it is "unclear . . . that a supplier would profit from limiting its market by excluding potential dealers." *Id.* In addition, to the extent that maximum resale prices "might limit the viability of inefficient dealers, that consequence is not

necessarily harmful to competition and consumers." 522 U.S. at 17.

"After reconsidering *Albrecht*'s rationale and the substantial criticism the decision has received," the Court unanimously concluded "that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing." 522 U.S. at 18. Accordingly, the Court unanimously held that "vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason." *Id.* at 22.

III. Under Principles Recognized in *State Oil* and Other Decisions of this Court, Vertical Minimum Resale Price Maintenance Should Be Subject To The Rule of Reason Rather Than The *Per Se* Rule.

A. Vertical Minimum RPM Is Not Always, Or Almost Always, Anticompetitive.

There is widespread agreement among legal and economic scholars that vertical minimum resale price maintenance is not always, or almost always, anticompetitive.[3] To the contrary, minimum prices may

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[3] *See, e.g.*, 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶ 1620-1633 (2d ed. 2004); Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 Wash. U.L.Q. 657, 697-707 (2005); Robert H. Bork, *The Antitrust Paradox* 280-98 (1978); Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 423, 435-37 (4th ed. 2005); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996); Frank H. (continued...)

actually enhance interbrand competition by ensuring that dealers provide the optimum level of service to consumers. Absent minimum price restraints, price-cutting dealers may free-ride on dealers that provide a higher degree of service to consumers. Such free-riding may make it difficult or impossible for dealers to provide the optimum level of service to consumers while remaining profitable.[4]

Minimum prices may enhance interbrand competition in a variety of ways. For example, they may encourage retailers to make investments in improving service to customers, such as training retail sales personnel and making physical improvements to retail locations.[5] Minimum prices may encourage dealers to stock larger quantities of a product, by eliminating concern that price-cutting by other dealers will decrease

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Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135 (1984); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991); Richard A. Posner, *Antitrust Law* 172 (2d ed. 2001); W. Kip Viscusi, John M. Vernon & Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 283 (4th ed. 2005); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72 (1993). An experienced economist serving as an expert witness for Petitioner in this case stated: "I know of no economist who presently endorses a *per se* approach to either vertical price or non-price marketing practices that are unilateral and implemented by firms without market power." Pet. App. 40a.

[4] *See, e.g.*, Blair et al., *supra* note 3, at 698-700.

[5] *See, e.g.*, Carlton & Perloff, *supra* note 3, at 420-421.

the value of the inventory.[6] In addition, minimum prices may encourage dealers to provide shelf space to a new product, and thus may be a particularly effective way for new products and smaller competitors to gain a foothold with dealers.

The facts of this case indicate that the manufacturer's pricing strategy benefited consumers rather than harming them. Petitioner's sales increased significantly while its pricing policy was in effect, from 125,609 units in 1996 to 375,480 units in 2003. Pet. 3. Because Petitioner is a relatively small competitor with no market power, this substantial increase in sales strongly suggests that its marketing strategy coincided with consumers' preferences. Whether Petitioner's success resulted from inducing dealers to provide the optimum level of service, scarce shelf space, optimum levels of inventory, or for some other reason or combination of reasons, the policy appears to have benefited rather than harmed consumers and competition.

There is no persuasive reason to draw a sharp distinction between vertical price restraints and vertical nonprice restraints. Both types of vertical restraint generally reduce intrabrand competition while increasing interbrand competition. As the Court has explained, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that. In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the

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[6] *See, e.g.*, Deneckere et al., *Demand Uncertainty*, *supra* note 3, at 907-10.

dealer's profit margin permits provision of the desired services." *Business Electronics*, 485 U.S. at 727-29.[7]

At times, a manufacturer may be mistaken about the value of minimum resale prices. This should not be a matter of special antitrust concern, however, because such mistakes are likely to be self-correcting. A manufacturer has no incentive to impose minimum prices if doing so will reduce overall sales and profits, and thus has no reason to impose vertical price restraints unless they will induce the provision of dealer services that consumers want and are willing to pay for.

Under a rule of reason analysis, a court must consider (among other factors) whether the manufacturer or the dealer possess market power – *i.e.*, the power to profitably charge more than the competitive price for a product. It is important to note, however, that even if a manufacturer has market power, it is unlikely to adopt minimum resale prices as a device to achieve anticompetitive ends. A manufacturer with market power can exercise that power directly by charging a higher price to its dealers.[8] A manufacturer thus has no

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[7] The Court initially extended the *per se* rule to nonprice restraints as well as price restraints. *See Schwinn*, 388 U.S. at 379. When the Court concluded that subsequent experience justified overruling *Schwinn* and applying the rule of reason to vertical nonprice restraints such as exclusive dealer territories, it began a process that led to reexamination of vertical price restraints in *State Oil* and this case.

[8] The exercise of market power is not a violation of the antitrust laws, so long as the manufacturer's market power was lawfully obtained. *See United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (distinguishing "the willful acquisition or maintenance of . . . power" from "growth or development as a (continued...)

need to impose minimum resale price restraints to obtain the economic benefit of any market power it may possess.

To be sure, vertical minimum resale price maintenance may harm competition in some circumstances. For example, minimum resale price restraints may be used to facilitate a horizontal price fixing agreement at the dealer or manufacturer level. There is little evidence that this is a common occurrence, however. Moreover, horizontal price fixing – at any level of the chain of distribution – is a *per se* violation of the antitrust laws, and would remain so if *Dr. Miles* were overruled. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940). In addition, vertical minimum resale price maintenance would remain subject to analysis under the rule of reason. Where rule-of-reason analysis indicates that the risk of anticompetitive harm outweighs the likely procompetitive benefits, vertical minimum price maintenance will be condemned.

B. The Court's Reasoning in *State Oil* Supports Reconsideration Of *Dr. Miles*.

This Court's reasoning in *State Oil* strongly supports the conclusion that vertical minimum resale price maintenance, like vertical maximum resale price maintenance, should be subject to the rule of reason rather than the *per se* rule.

First, State Oil (and other decisions of this Court) recognize that "any departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . formalistic line drawing." 522 U.S. at 14, citing *GTE Sylvania*, 433 U.S. at 58-59. The *per se* rule is limited to restraints that have "predictable and

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consequence of a superior product, business acumen, or historic accident.").

pernicious anticompetitive effect" coupled with "limited potential for procompetitive benefit." 522 U.S. at 10. The Court's legal analysis is informed by "scholarship discussing the effects of vertical restraints," as well as its recognition that "the primary purpose of the antitrust laws is to protect interbrand competition." *Id.* at 15, citing *Business Electronics*, 485 U.S. at 717. *See also Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281, 1291 n.4 (noting that the Court's decision to abandon the presumption that a patent confers market power "accords with the vast majority of academic literature on the subject."). The overwhelming weight of scholarship supports the conclusion that vertical minimum resale price maintenance is not always, or almost always, anticompetitive, and thus should not be subject to the *per se* rule.

Second, the Court's reasons for rejecting the purported justifications for a *per se* rule against vertical maximum resale price maintenance (such as "dealer freedom," preventing dealers from offering the level of services that consumers demand, and preventing manufacturers from disadvantaging particular dealers, *see* 522 U.S. at 16-17) apply with equal force to the *per se* rule against minimum resale prices, and support the conclusion that all vertical resale price restraints should be subject to the rule of reason rather than the *per se* rule.

It is true, as the Court noted in *State Oil*, 522 U.S. at 15-16, that vertical maximum prices tend to hold down the prices charged to consumers. Vertical minimum prices, of course, tend to have the opposite effect. As explained above, however, vertical minimum prices, like vertical maximum prices, often enhance interbrand competition and thus benefit consumers. Consequently, this factor is not a sufficient basis for retaining the *per se* rule of *Dr. Miles* while overruling *Albrecht*.

C. The *Per Se* Rule of *Dr. Miles* Should Be Reconsidered Because Its Application Is Unpredictable and Turns on Economically Irrelevant Factors.

Shortly after the Court outlawed vertical minimum resale price maintenance in *Dr. Miles*, it held that a manufacturer has a right to select its dealers, and may unilaterally refuse to do business with dealers that decline to adhere to the manufacturer's suggested resale prices. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The Court's decision in *Colgate* mitigated the harmful economic effects of *Dr. Miles*, but at a cost. The interaction between *Dr. Miles* and *Colgate* has led courts to focus on whether manufacturers and dealers have entered into an agreement on resale prices that satisfies Section 1's requirement of a "contract, combination or conspiracy." Rather than considering the effect of the challenged restraint on consumers or competition, courts have concentrated on the nature and extent of communications between the manufacturer and the dealer. Litigation frequently focuses on whether manufacturers have engaged only in permissible price suggestions, or instead have crossed the line into impermissible "coercion" of dealers.[9]

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[9] Professors Areeda and Hovenkamp state that "courts have been bedeviled to determine which of [the following] practices constitutes or reflects an agreement" between a manufacturer and a dealer: (1) a manufacturer sells only to "congenial" dealers unlikely to discount prices and terminates dealers that prove uncongenial; (2) a manufacturer suggests resale prices that are widely followed; (3) a manufacturer announces and implements a policy of ceasing to supply dealers that sell below suggested resale prices; (4) a manufacturer implements a policy of ceasing to supply price-cutting dealers in a "complex" (continued...)

Similarly, manufacturers have long been permitted to set minimum prices on consignment sales, on the theory that there is no "restraint on alienation" where title to the goods has not passed from the manufacturer to the dealer. *See United States v. General Electric Co.*, 272 U.S. 476, 488 (1926) ("genuine contracts of agency" do not violate Section 1 because "the owner of an article, patented or otherwise" is not prohibited from "fixing the price by which his agents transfer title from him directly to [a] consumer"). This, in turn, has led to litigation over whether a particular arrangement is a "true" consignment. *See, e.g., Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). Again, a focus on the terms of a particular

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manner; (5) a manufacturer exhorts dealers generally concerning resale prices, or threatens or negotiates with individual dealers, with or without an announced resale price policy; (6) a manufacturer ceases to supply a dealer after a complaint by another dealer about the terminated dealer's prices, or after the dealer "coerces" the manufacturer to terminate the price-cutting dealer; (7) the manufacturer conditions a reimbursement on resale prices; or (8) the manufacturer varies its price to the dealer based upon the dealer's resale price. 8 Areeda & Hovenkamp ¶ 1630, at 304-05. Areeda and Hovenkamp report that Situations 1 and 2 "are generally deemed not to create any agreement." *Id.* at 305. Although *Colgate* held that Situation 3 is not an agreement, the Court "seemed to retreat from that holding" in *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960), before reviving it in *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984). 8 Areeda & Hovenkamp at 305. *Monsanto* "does not foreclose finding an agreement in" Situations 4 and 5. *Id.* Situation 6 "has generally been held not to be an agreement" since *Monsanto*, "although the lower court decisions are not consistent." *Id.* Situations 7 and 8 "also have not brought consistent results." *Id.*

consignment arrangement ignores the actual economic effects of the challenged restraint on consumers in favor of formalistic considerations that are likely to be economically irrelevant.

While the boundary line between *Dr. Miles* and *Colgate* has remained fuzzy, it has shifted over time. In *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960), the Court held that the *Colgate* rule does not apply when the manufacturer takes "affirmative action to achieve uniform adherence" to its resale pricing policy. More recently, the Court has largely restored the scope of the *Colgate* doctrine. In *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 & n.9 (1984), the Court held that when a manufacturer terminates a price-cutting distributor following complaints from another distributor, no anticompetitive agreement may be inferred absent "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributor were acting independently" and "reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective." And in *Business Electronics*, the Court held that an agreement between a manufacturer and one of its dealers to terminate a price-cutting dealer was not *per se* unlawful, so long as the manufacturer and the surviving dealer did not agree on resale prices. *See* 485 U.S. at 735-36.

Even after *Monsanto* and *Business Electronics*, the *per se* rule of *Dr. Miles* continues to require courts and lawyers counseling clients to focus on fact-intensive issues that are largely irrelevant to the actual economic effects of the challenged restraint. The focus on issues such as whether there is an agreement between manufacturers and dealers, whether dealers have been coerced, and whether there is a "true" consignment arrangement impose real costs by creating legal uncertainty and fostering expensive litigation. Moreover, the current legal

rules are directly contrary to the Court's recognition that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *GTE Sylvania*, 433 U.S. at 58-59. The interaction between *Dr. Miles* and *Colgate* thus provides an additional basis for re-examining the antitrust treatment of vertical minimum resale price maintenance and concluding that it should be analyzed under the rule of reason rather than the *per se* rule.

IV. Applying The Rule of Reason to Vertical Minimum RPM Is Consistent With Principles of *Stare Decisis*.

The Court decided *Dr. Miles* in 1911, before it had fully developed the distinction between the *per se* rule and the rule of reason. Moreover, there was evidence that the resale price restriction at issue in *Dr. Miles* may have resulted from a horizontal agreement among wholesale druggists. *See Areeda & Hovenkamp* ¶ 1620, at 211; Herbert Hovenkamp, *Enterprise and American Law, 1836-1937*, ch. 25 (1991). If so, the result in *Dr. Miles* (and the application of the *per se* rule to a *horizontal* price-fixing agreement among druggists) was correct, without regard to whether vertical minimum resale price maintenance is itself a *per se* violation of Section 1. That said, *Dr. Miles* has long been understood as adopting a *per se* rule against vertical resale price maintenance. *See, e.g., Business Electronics*, 485 U.S. at 724; *324 Liquor v. Duffy*, 479 U.S. at 341-43; *Monsanto*, 465 U.S. at 761. Even on that understanding, however, principles of *stare decisis* do not prevent the Court from reexamining the rule and bringing it into alignment with this Court's other decisions interpreting Section 1 of the Sherman Act.

The doctrine of *stare decisis* is a "principle of policy," *Helvering v. Hallock*, 309 U.S. 106, 119 (1940), not an "inexorable command." *Payne v. Tennessee*, 501 U.S. 808, 828 (1991). Although the Court generally is reluctant to overrule its statutory precedents, on the

ground that "Congress is free to change this Court's interpretation of its legislation," *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977), the Court has not hesitated to overrule its statutory precedents "when the intervening development of the law ha[s] 'removed or weakened the conceptual underpinnings from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies.'" *Neal v. United States*, 516 U.S. 284, 295 (1996), quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). As explained above, the conceptual underpinnings of *Dr. Miles* have been removed by the Court's subsequent decisions concerning vertical restraints, including *State Oil* and *GTE Sylvania*.

Moreover, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.'" *State Oil*, 522 U.S. at 20-21, quoting *National Society of Professional Engineers v. United States*, 435 U.S. 679, 688 (1978). Indeed, as the Court has recognized, the statutory phrase "restraint of trade" in Section 1 of the Sherman Act "invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890." *State Oil*, 522 U.S. at 21, quoting *Business Electronics*, 485 U.S. at 732 (additional citations omitted). Many basic legal principles under Section 1 – including the distinction between horizontal and vertical agreements, the distinction between the *per se* rule and the rule of reason, and the principle that Section 1 forbids only unreasonable restraints of trade – were developed by this Court. The Court thus has been more willing to reconsider its Sherman Act precedents than it would be to reconsider other statutory precedents. *See, e.g.*, *State Oil*, 522 U.S. at 20-22 (reconsidering *per se* rule against vertical maximum resale price maintenance); *GTE Sylvania*, 433

U.S. at 47-57 (reconsidering *per se* rule against vertical territorial restrictions); *see also Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 126 S. Ct. at 1281, 1289-91 (reconsidering presumption that patents confer market power).[10]

Accordingly, the doctrine of *stare decisis* does not prevent the Court from reconsidering *Dr. Miles* and bringing the antitrust analysis of vertical minimum retail price maintenance into alignment with the Court's other precedents concerning vertical restraints.

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[10] Although Congress has legislated with respect to minimum resale price maintenance – first authorizing States to permit minimum resale price maintenance in the Miller-Tydings Act of 1937, Pub. L. No. 75-314, 50 Stat. 693, and the McGuire Act of 1952, Pub. L. No. 82-543, 66 Stat. 631 (1952), and then withdrawing that authorization in the Consumer Goods Pricing Act of 1975, Pub L. No. 94-145, 89 Stat. 801 – this series of legislative enactments should not be understood as freezing in place for all time this Court's decision in *Dr. Miles*. Rather, Congress's enactment and subsequent repeal of the Miller-Tydings and McGuire Acts leaves responsibility for interpreting Section 1 of the Sherman Act with this Court. *See* Easterbrook, *supra* note 3, at 139 ("The choice made in 1975 was to return RPM issues to the control of antitrust principles, free of state law, rather than to adopt a legislative rule specifying how to treat RPM."). The Court should apply the language of Section 1 to vertical minimum resale price maintenance in a way that is congruent with the interpretive principles this Court has developed and applied in other antitrust cases.

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted,

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